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SUBJECT: ARGENTINA'S PARIS CLUB ANNOUNCEMENT PROMPTS
ACCLAIM AND RESERVATIONS

REF: A. BUENOS AIRES 1224

[1](#)B. BUENOS AIRES 1233

Summary

[1](#)1. (SBU) The local reaction to the Argentine President's surprise September 2 announcement to pay Paris Club debt has been mildly positive. The GoA is promoting the action as part of a larger "debt reduction, development, and growth" initiative. GoA officials expressed satisfaction with the positive USG statement, although local media interpreted part of the statement as a call for paying holdout bondholders as well.

[1](#)2. (SBU) Argentine industry has been most vocal in praising the initiative, emphasizing the expected positive outcomes: restoring Argentina's image, gaining confidence in the economy, and accessing lower-cost financing. Spain, Italy, Germany, and France also are reported to have issued positive statements, and the Paris Club secretariat's statement attracted much attention (septel). Many normally critical media commentators, opposition politicians, and farming groups also complimented the decision, while some of the GoA's most leftist supporters criticized the move. However, the garlands of praise were accompanied by reservations about paying in a lump-sum with official reserves and arguing that it does not address the real problems facing the country.

[1](#)3. (SBU) Markets have reacted cautiously to the announcement, with investors waiting for clearer signals of change. Argentine and foreign economists and financial analysts, especially those associated with Menem-era economic policies, have been among the most skeptical of the decision's impact. Septels will cover Central Bank, Finance Secretariat, and Paris Club Secretariat reactions, as well as questions related to legal aspects of the decision and the timeframe for implementation. End Summary.

President Shocks Country with Paris Club Plan

[1](#)4. (SBU) Argentines have responded positively to Argentine President Cristina Fernandez de Kirchner's (CFK) announcement (Reftel) that she had signed a decree instructing the Economy Ministry to pay Paris Club debt using Central Bank reserves. GoA officials were out in force following the announcement, promoting the decision to the media and underscoring the positive repercussions that would come of it, including restoring confidence in Argentina. Chief of Staff Sergio

Massa told local media that the GoA took the action in order to continue reducing debt to multilateral organizations and bilateral creditors (a logical follow-on to the January 2006 payment to the IMF), break the vicious cycle of constant Paris Club debt restructurings since 1983, and open access to credit for the government and Argentine firms. According to leading daily Clarin, Massa also claimed that CFK had consulted on the issue with the Heads of Germany, Italy, France, Spain, and also with WHA A/S Tom Shannon during his recent visit. (Comment: We believe these "consultations" may refer to nothing more than a general discussion of the Paris Club issue and the need to resolve it. End Comment.)

15. (SBU) Central Bank President Martin Redrado, in his closing speech at the Central Bank's annual monetary and banking conference, threw his full support behind the announcement, even though he is rumored to have been kept out of the loop on the decision until the last minute. (According to press reports, CFK and her husband, ex-President Nestor Kirchner, kept a close-hold on the initiative, involving only close advisors Oscar Parilli, General Secretary to the President, Carlos Zaninni, Legal and Technical Secretary, and -- possibly -- Chief of Cabinet Sergio Massa.) Redrado has long opposed using reserves to pay the Paris Club but, playing the good soldier, argued that the payment was "part of an integral strategy" to regain access to markets and "reinsert Argentina into the international financial community."

Roll-Out as Part of Larger Package

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16. (SBU) The GoA is promoting the proposed payment as part of a larger "debt reduction, development, and growth" initiative. It took out full-page advertisements in all local papers to introduce the initiative, and announced in addition to the Paris Club payment the signing of an agreement with Brazil's development bank (BNDES), new credits from state-owned Banco de la Nacion to Argentine exporters and small- and medium-size businesses, and stronger anti-dumping measures, all with the apparent goal of increasing jobs, local production, and "social mobility," and emphasizing the role of the state in "development and growth." Details on this broader initiative are still lacking.

Positive U.S. Statement Reassures GoA

17. (SBU) GoA officials were quoted in the press expressing satisfaction with the USG statement, issued late September 2, with press reports highlighting the U.S. comment that the announcement was a positive step. Press reports also indicated supportive statements from Spain, Italy, France, and Germany. While the two main papers -- Clarin and La Nacion -- highlighted the encouraging tone of the U.S. press release, both stated in front-page headlines that the USG had also called for the normalization of financial relations with all external creditors. Both papers interpreted this as a reference to untendere debt holders (the so-called "holdout" bondholders that did not participate in the 2005 debt exchange.)

Argentine Industry Accentuates the Positives

18. (SBU) Argentine private sector representatives, including leaders of the main industry associations, were most vocal in supporting the decision. The Presidents of the Argentine Business Association and the Argentine Chamber of Commerce (CAC) pledged support and emphasized that the move would lead

to investment and improved access to credit. They and other local business representatives highlighted the expected positive outcomes of the initiative, including restoring Argentina's tarnished image in the world and regaining confidence in the economy.

¶9. (SBU) CAC President Carlos de la Vega asserted that paying Paris Club creditors would allow Argentina to access lower-cost financing, particularly via official Export Credit Agencies, such as U.S. EXIM, France's COFACE, and Germany's HERMES. He specified that such credits would enable the country to modernize its economic and social infrastructure. Juan Carlos Lascurian, the head of the powerful Industrial Union, agreed with this sentiment, adding that this was "a fundamental step and important signal to the world, and would help Argentina to recoup the confidence of developed countries."

Opposition Supports Payment, Criticizes Means

¶10. (SBU) Many normally critical media commentators, opposition politicians, and farming groups also made complimentary statements regarding the decision to pay Paris Club members. These included opposition leaders Elisa Carrio (second place finisher in the 2007 Presidential election) and Buenos Aires Mayor Mauricio Macri, both of whom emphasized the importance of complying with Argentina's debt obligations and reintegrating with world capital markets. Estranged Vice President Julio Cobos applauded the decision, noting it would help create better conditions for future investment. Another striking feature of the reaction came from leftist leader Luis D'Elia, the street activist who was one of the government's most unqualified supporters during the recent farm strike. D'Elia criticized the announcement, saying that, "Cristina Fernandez surprised us with her decision to write off the now nearly chronic debt with the Paris Club."

¶11. (SBU) Leaders of three of the four main farming groups -- until recently in a battle with the GoA over export taxes -- echoed these arguments. (Eduardo Buzzi, leader of the

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Agrarian Federation, which represents small- and medium-size farmers, questioned the origin of the debt and recommended restructuring it.) Luciano Miguens, President of the large-holders association, Sociedad Rural, made the strongest case for clearing Paris Club debt, arguing that "it will surely have positive effects on the economy, in particular with regards to access to international credit, increased investment, recuperation of bond prices, and diminution of country risk."

¶12. (SBU) Nevertheless, most of these commentators qualified their statements, and in particular disagreed with the GoA's decisions to pay the Paris Club in a lump sum using official reserves. Macri argued the GoA should have tried to restructure the debt. Carrio noted that the payment was late, did not form part of an overall financial restructuring plan, and demonstrated weakness on the part of the government (due to its need to rely on reserves). Macri's PRO opposition party chimed in via a press release on September 3, stating that complying with external obligations is fundamental, but using reserves was unnecessary. Many other Argentine observers agreed, highlighting the possible detrimental impact on the Central Bank and also arguing that the payment does not address the real problems facing Argentina: high inflation, statistics manipulation, lack of access to capital markets, and overall crisis of confidence.

Markets Flat Pending Clearer Signals

¶13. (SBU) Investors have reacted cautiously to the news, and

the marginal gains in Argentine peso and dollar bonds and in Argentina's main stock market (Merval) following the 12:00 p.m. announcement on September 2 mostly eroded on September 3 and 4, amidst low volume. Argentina's country risk rating, as measured by JP Morgan's Emerging Market Bond Index Plus, widened to 693 basis points on September 3, after closing at 678 basis points September 2 (and down from a recent high of 741 on August 8). Argentina's Credit Default Swaps (CDS) tightened about 20 basis points following the announcement and gave up the gains on September 3 and 4 (at market close on September 4, five-year and ten-year CDS were trading at 769 and 841 basis points, respectively). The peso has only slightly depreciated since the announcement, despite market concerns that the Central Bank may decide to increase dollar purchases to build back reserves. Local analysts are mostly quoted stating that the market is waiting for clearer signals on what further actions the government will take, particularly with regards to restoring confidence in government statistics and slowing spending growth in order to reduce the rate of inflation.

Analysts Remain Unconvinced

¶14. (SBU) As reported Reftel, the initial reaction of many local economists has been negative, albeit with some open to the possibility that the decision could be net-positive if it turns out to reflect a change of course in GoA economic policy. Several local analysts have also noted that it is better for the GoA to use reserves to pay down debt than to finance increased spending (which some GoA supporters have called for in the past). Nevertheless, most local analysts' view is that the move unwisely uses reserves; reflects GoA desperation to find sources of financing; raises concerns about Central Bank solvency and the stability of the exchange rate; and could empower the GoA to finance huge, white-elephant infrastructure projects, such as the \$4 billion proposal by the French company Alstom to build a bullet train between Buenos Aires and Rosario.

¶15. (SBU) Foreign Bank analysis is broadly similar. Goldman Sachs' assessment is that the payment is "a welcome and positive step to regularize Argentina's financial standing with the world...but does not resolve the main macroeconomic problems currently facing Argentina, namely high inflation and a high fiscal and financial dependence on commodity prices." JP Morgan sees it as positive that "authorities are no longer able to overlook the binding financial constraints that market spreads are signaling," but argues that "the one-off nature of the Paris Club payment reveals Argentina's preference for maintaining the current policy mix."

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¶16. (SBU) Citi and Lehman commentaries are more critical, noting that the decision erases any notion of Central Bank independence, opens the door to further litigation from holdouts, and undermines the Central Bank's balance sheet. Lehman's Guillermo Mondino, an Argentine who is a long-time critic of the Kirchners, notes that despite supporters' assertions that the act demonstrates GoA willingness to meet debt obligations, the Paris Club payment reduces available Argentine assets and therefore actually raises doubts about the GoA's capacity to pay future debts. (Mondino worked for Domingo Cavallo when he was Economy Minister in 2001. Cavallo has also criticized the decision, for the same reasons listed above.)

¶17. (SBU) Almost all analysts consider it negative that the GoA will avoid the IMF by clearing all Paris Club debt. Barclay's view is typical: "this solution to the Paris Club issue is inferior to the more conventional negotiated rollover and reflects both the intention to reassure the market of its willingness to pay and the decision to avoid the required surveillance program with the IMF. The cash

payment is a costly choice since it is unlikely to lower the elevated risk premium that the country will face to roll over short-dated debt or to provide much relief for next year's financing needs -- the focus of recent market stress...While (it) should open the door for bilateral infrastructure and trade credits...the opportunity cost of liquid reserves ultimately casts doubt on the effectiveness of the message."

Comment

¶18. (SBU) While overall reaction may be more mixed than the GoA expected, the surprise of the announcement was complete and shocked both the political establishment and markets. This is the first time that the CFK administration has proactively set the agenda -- getting out ahead of the press and public opinion -- in contrast to its record over the last eight months of constantly reacting to events. If the Kirchners thought they needed a big event to shake up the political/economic system in Argentina, they got it -- along with everyone's attention. The GoA now has an opportunity to expand on this announcement to demonstrate a shift towards more rational economic policies. The question is whether this populist, market-skeptical government will seize the day.
WAYNE